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National Energy Board

Reasons for Decision

L&J Energy Systems, Inc.

GH-2-91

May 1991



Gas Export



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National Energy Board

Reasons for Decision

In the Matter of

L&J Energy Systems, Inc.

**Application For Review of Gas Export
Licence GL-148 under Subsection 21(1) of
the *National Energy Board Act***

GH-2-91

May 1991

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Recital and Appearances

IN THE MATTER OF the *National Energy Board Act* and the regulations made thereunder;

AND IN THE MATTER OF an application by L&J Energy Systems, Inc., dated 26 March 1990, pursuant to Part VI of the *National Energy Board Act* for a licence authorizing the export of natural gas;

AND IN THE MATTER OF the National Energy Board's Reasons for Decision GH-3-90; and

AND IN THE MATTER OF an application by L&J Energy Systems, Inc. for a review of gas export Licence GL-148.

HEARD at Ottawa, Ontario on 7 May 1991.

BEFORE:

W.G. Stewart	Presiding Member
A.B. Gilmour	Member
K.W. Vollman	Member

APPEARANCES:

L.G. Keough	L&J Energy Systems, Inc.
S. Scott	National Energy Board

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Abbreviations

Act	the <i>National Energy Board Act</i>
Bcf	billion cubic feet
Board	National Energy Board
GH-3-90	Reasons for Decision in the matter of Husky Oil Operations Ltd. Mobil Oil Canada, Ltd. L&J Energy Systems, Inc. Applications Under Part VI of the <i>National Energy Board Act</i> for Licences to Export Natural Gas
L&J	L&J Energy Systems, Inc.
Morgan	Morgan Hydrocarbons Inc.
m ³	cubic metres
Unigas	Unigas Corporation

Background

By application dated 26 March 1990, L&J Energy Systems, Inc. ("L&J") applied to the National Energy Board ("the Board") for a gas export licence authorizing over a 15-year term the export of $1815.9 \text{ } 10^6 \text{m}^3$ (64.1 Bcf). Subsequent to the hearing of that application in the GH-3-90 proceeding, the Board decided to issue export Licence GL-148 to L&J authorizing the export of $1455.6 \text{ } 10^6 \text{m}^3$ (51.4 Bcf) with a 12-year term. The Board reached its decision not to authorize the full applied-for volume and term on the basis that it was concerned that its estimate of productive capacity was lower than the applied-for volume over the latter portion of the proposed export term. Further, the Board found that Morgan Hydrocarbons Inc. ("Morgan") was not contractually obligated to dedicate additional reserves and was not subject to contractual penalties if deficiencies in productive capacity were to occur.

By application dated 29 January 1991, L&J requested the following with respect to Licence GL-148:

- (1) that the Board issue an order under subsection 21(2) of the *National Energy Board Act* ("the Act") extending the term of GL-148 from 12 to 15 years and authorizing the export of a term quantity of $1815.9 \text{ } 10^6 \text{m}^3$ (64.1 Bcf) as was originally applied-for; and

- (2) that the Board conclude that no public process is required in order to dispose of the request to vary GL-148.

Under cover of letter dated 4 March 1991, the Board denied L&J's application for a variance pursuant to subsection 21(2) of the Act. The Board considered that the variance applied for was of a substantive nature, and accordingly, expressed the view that the relief sought was in the nature of a review to which the requirements of section 41 of the draft *NEB Rules of Practice and Procedure* would apply.

By letter dated 11 March 1991, L&J requested that the Board treat its 29 January 1991 application, as an application for review pursuant to section 21 of the Act and that the Board determine that no public process was required in order to complete the review of Licence GL-148.

In response to L&J's request, the Board, in a letter dated 11 April 1991, advised L&J that in its opinion this request was tantamount to a request for a new licence for which a public hearing would be required. The Board also advised that the review would be conducted on the basis of the submissions contained in L&J's letters dated 29 January and 11 March 1991. Subsequently, the Board issued Hearing Order GH-2-91 which set the L&J application down for hearing in Ottawa on 7 May 1991.

2.1 The Application

In support of its application for an additional term of three years and a corresponding increase in the maximum term quantity, the applicant submitted in evidence an amendment to the Gas Purchase Contract between L&J and Morgan dated 9 March 1990. The amendment is as follows:

5.8 If on any Day, there is insufficient gas available for delivery from the Dedicated Lands to satisfy the nomination by Buyer pursuant hereto for deliveries on such Day, then Seller, to the extent that it is able to do so, shall satisfy such shortfall out of gas produced from other lands owned by Seller which Seller is not prevented, by contractual restrictions or otherwise, from delivering to Buyer.

At the hearing, L&J testified that it understood this clause to mean that Morgan would be obligated to continue to deliver gas from its undedicated reserves pool in the event that there is a shortfall in deliverability under this contract. Morgan concurred with this view noting that it is difficult for a company of its size to provide both specific reserves dedication and a corporate warranty. Morgan submitted that to do so would restrict its flexibility in the management of its supply portfolio in that L&J would be entitled to all of Morgan's production. During cross-examination, Morgan added that it maintains between 10 and 20 percent of its gas reserves for sale into shorter-term markets which could be curtailed in order to satisfy longer-term commitments such as that of L&J. Morgan stated that this practice of maintaining gas reserves for shorter-term markets was a matter of company policy which it planned to continue. However, Morgan underlined that it was not contractually obligated to maintain this practice.

L&J stated that, with the addition of a corporate warranty clause in the contract, it was satisfied

that the risk of Morgan not being able to meet its contractual obligation was acceptable, in spite of the Board's finding in the GH-3-90 proceeding that its estimate of productive capacity would not satisfy the applied-for requirements beyond 1999.

It was L&J's view that with the inclusion of this corporate warranty clause, the concerns raised by the Board in its GH-3-90 Reasons for Decision had been adequately addressed and that this alone should provide the Board with the basis on which to grant L&J's request.

In its GH-3-90 Reasons for Decision, the Board also expressed the concern that the contract between L&J and Morgan did not provide for contractual penalties if deficiencies occurred. In this regard, Morgan testified that no amendments had been made to the contract to address this matter.

With respect to the financing of the project, L&J stated that, although it might be possible to arrange financing on the basis of a 12-year term, it was uncertain as to whether or not the terms and conditions of such financing would be acceptable to L&J. L&J stated that it has proceeded on the basis that financing would be sought over a 15-year term, and that the term of the financing and the export licence have to match. L&J stressed the importance of having a gas supply for the full 15 years so that it could secure financing with the best terms and conditions available to it. Further, L&J argued that in order to ensure that it obtain terms and conditions that will allow the project to proceed, a finding by the Board that there is gas supply for the full 15 years will enable L&J to operate from a position of strength as opposed to one of weakness in its negotiations on financing.

At the GH-3-90 proceeding, Morgan had indicated that it could rely on the development of additional reserves on its dedicated lands as well as 992-1134 10^6m^3 (35-40 Bcf) of uncontracted reserves in the

event that shortfalls in deliverability were to occur. In bringing the Board up to date on its current situation, Morgan stated these reserves would now be in the $992\text{--}1247 10^6\text{m}^3$ (35-44 Bcf) range of which 15 to 20 percent had been tied in and are producing. In addition, Morgan also advised the Board that $567\text{--}680 10^6\text{m}^3$ (20-24 Bcf) of the revised total of uncontracted reserves was now committed to Unigas Corporation ("Unigas") under a gas sales arrangement.

L&J noted that, in its GH-3-90 Reasons for Decision, the Board, while expressing concern about the potential for shortfalls in productive capacity, also recognized the potential for increases in Morgan's gas supply. In this regard, L&J observed that Morgan had carried out additional development on the dedicated lands since GH-3-90.

L&J also informed the Board that there had been no change to the forecasted load factor of 92 to 95 percent for the cogeneration facility and that this estimate took into account the possibility of an interruption of service on the Iroquois system of approximately 15 days per year.

Morgan stated that it continues to be a vibrant and active oil and gas company as its revenue, cash flow, oil and gas reserves and production, and capital budget have all increased since 1989.

2.2 Views of the Board

In the GH-3-90 Reasons for Decision, the Board's estimate of reserves were found to be approximately equal to the applied-for volume. Notwithstanding this, the Board decided to curtail the term and term volume of gas export licence GL-148 as its estimate of productive capacity did not meet the applied-for requirement beyond 1999. In addition, the Board expressed its concern that Morgan was not contractually obligated to dedicate additional reserves in the event of productive capacity shortfalls. With the inclusion of the corporate warranty clause, L&J has now satisfied, at least in part, that concern. The Board would have

preferred that the contractual obligation be stronger than what has been negotiated between L&J and its supplier. The Board notes the fact that it is Morgan's policy to retain 10 to 20 percent of its gas reserves for short-term sales. This being the case, in the event that productive capacity shortfalls were to occur, to the extent that it is able to do so, Morgan would then be contractually obligated to satisfy L&J's requirements.

In its GH-3-90 Reasons for Decision, the Board recognized that there could potentially be an increase in L&J's estimate of gas supply. The Board notes that since that time this has indeed occurred, as Morgan has continued to develop dedicated lands since the GH-3-90 proceeding. It should be noted however, that a portion of the uncontracted reserves identified at that time have now been contractually dedicated to Unigas.

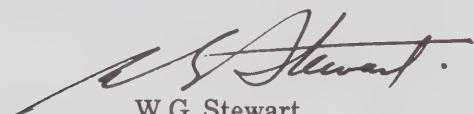
The Board is confident that Morgan will continue to add to its gas supply with additional discoveries which could reduce the possibility of L&J experiencing productive capacity shortfalls. In the event that they do occur, the Board is satisfied that Morgan's policy of maintaining up to 20 percent of its gas reserves for sale in short-term markets will, along with the corporate warranty, satisfy any such shortfall.

L&J confirmed that the load factor associated with exports under GL-148 is still forecast to be in the 92 to 95 percent range. The Board notes that should exports be made at such load factor levels, it would tend to reduce the possibility of productive capacity shortfalls during the later years of the licence.

The Board understands and can fully appreciate that in order to secure the best terms and conditions, L&J would prefer to have financing of the project over a 15-year period as opposed to a 12-year period. In view of the fact that the terms of the financing and the export licence should match, the Board is of the view that it would be desirable from a commercial standpoint for L&J to be granted a 15-year licence in this particular case.

Disposition

For the reasons discussed in section 2.2, the Board has decided to vary export Licence GL-148 by extending the term from 12 to 15 years and by authorizing the export of a term quantity of 1815.9 10^6m^3 (64.1 Bcf).



W.G. Stewart
Presiding Member



A.B. Gilmour
Member



K.W. Vollman
Member

Ottawa, Canada
May 1991

**Terms and Conditions of the
Amended Licence to be Issued to
L & J Energy, Inc.**

1. The term of this Licence shall commence on the date of Governor in Council approval hereof or on the date of first deliveries, whichever is the later, and end on 1 November 1993 unless exports commence hereunder on or before 1 November 1993, in which case the term will end 15 years following the first day of the first month succeeding the commencement of firm deliveries.
2. Subject to condition 3, the quantity of the gas that may be exported under the authority of this Licence shall not exceed:
 - (a) 329 600 cubic metres in any one day;
 - (b) 121 300 000 cubic metres in any consecutive twelve-month period ending on 31 October; or
3. (a) As a tolerance, the amount that L&J may export in any 24-hour period under the authority of this Licence may exceed the daily limitation imposed in condition 2 by ten percent.
(b) As a tolerance, the amount that L&J may export in any consecutive twelve-month period under the authority of this Licence may exceed the annual limitation imposed in condition 2 by two percent.
4. Gas exported under the authority of this Licence shall be delivered to the point of export near Iroquois, Ontario.

